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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 847

THE UNITED STATES, PETITIONER

vs.

THE MUNSEY TRUST COMPANY OF WASHINGTON,
D. C. RECEIVER

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED JANUARY 3, 1947
CERTIORARI GRANTED MARCH 3, 1947

SUPREME COURT OF THE UNITED STATES

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CLAIMS

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In the Court of Claims of the United States

No. 46251

THE MUNSEY TRUST COMPANY OF WASHINGTON, D. C., RECEIVER

vs.

THE UNITED STATES

History of proceedings

The original petition was filed November 14, 1944.

On February 11, 1946, on motion made therefor and allowed by the court, an amended petition was filed which is as follows:

Amended Petition

Filed Feb. 11, 1946

To the Honorable, the Court of Claims:

1. The plaintiff, The Munsey Trust Company, of Washington, D. C., is a banking corporation under the laws of the District of Columbia, and brings this action as receiver appointed by the District Court of the United States for the District of Columbia in an action styled Irving Klein, plaintiff, v. Henry Morgenthau, Jr., Secretary of the Treasury of the United States, et al., defendants, being Civil Action No. 11643 in said Court.

2. The Federal Contracting Corporation, a corporation under the laws of the State of New York, entered into several contracts with the United States, acting through the Public Buildings Administration for the painting and repair of various public buildings of the United States as follows:

Post Office, Denver, Colorado.....	Contract WA-2-pb-531.
Post Office and Court House, Tulsa, Oklahoma.....	Contract WA-2-pb-629.
Post Office, Whitewater, Wisconsin.....	Contract WA-2-pb-597.
Customs House, Portland, Maine.....	Contract WA-2-pb-609.
Post Office, Skowhegan, Maine.....	Contract WA-2-pb-702.
Post Office, Gallup, New Mexico.....	Contract WA-2-pb-806.

The work under said contracts was fully performed by the Federal Contracting Corporation and progress payments were made on account thereof. At the conclusion of such work there remained due and owing from the United States to the contractor on account of each of said contracts the following amounts:

Denver, Colorado, Contract WA-2-pb-531.....	\$1,423.67
Tulsa, Oklahoma, Contract WA-2-pb-629.....	4,701.10
Whitewater, Wisconsin, Contract WA-2-pb-597.....	910.00
Portland, Maine, Contract WA-2-pb-609.....	3,649.00

Skowhegan, Maine, Contract WA-2-pb-702	\$391.00
Gallup, New Mexico, Contract WA-2-pb-806	954.00

3. The Aetna Casualty and Surety Company, a corporation under the laws of the State of Connecticut, became surety for the contractor upon its bonds securing performance of the work under each of the above-mentioned contracts as well as payment to all persons furnishing labor and material for use and which was used in the work. The Federal Contracting Corporation failed to pay various persons who had furnished labor and material for use in said work and the same were paid by The Aetna Casualty and Surety Company pursuant to the obligations of its several bonds. The amounts which the Federal Contracting Corporation failed to pay to furnishers of labor and material in connection with each contract and which were paid by The Aetna Casualty and Surety Company are as follows:

Denver, Colorado, Contract WA-2-pb-531	
Tulsa, Oklahoma, Contract WA-2-pb-629	\$8,640.10
Whitewater, Wisconsin, Contract WA-2-pb-597	648.00
Portland, Maine, Contract WA-2-pb-609	2,528.00
Skowhegan, Maine, Contract WA-2-pb-702	35.00
Gallup, New Mexico, Contract WA-2-pb-806	1,214.83

4. On October 18, 1940, the Federal Contracting Corporation submitted a bid in the sum of \$20,743 for the painting of the United States Post Office, Market, 17th and 18th Streets, St. Louis, Missouri. The said bid was accepted by the United States, but the Federal Contracting Corporation failed to enter into said contract and failed to give to the United States the bond required in connection therewith, as a consequence of which the United States caused the work to be performed at a cost of \$27,867, which together with the cost of readvertising the work in the amount of \$22.50, raised a charge against the Federal Contracting Corporation of \$7,146.50.

5. Thereafter, Irving Klein, as a stockholder of the Federal Contracting Corporation instituted an action in the District Court of the United States for the District of Columbia entitled Klein v. Morgenthau, Secretary of the Treasury, et al., Civil Action No. 11643, wherein he sued Henry Morgenthau, Jr., Secretary of the Treasury of the United States; William A. Julian, Treasurer of the United States; W. E. Reynolds, Commissioner of Public Buildings; The Federal Contracting Corporation; Charles Picoult; Frank Wunchel; and The Aetna Casualty and Surety Company. The plaintiff in said action sought the appointment of a receiver for the amounts payable by the United States under the several contracts herein mentioned and the marshaling of such amounts and equitable distribution thereof to such of the parties as might be properly entitled thereto. Subsequently this plain-

tiff was appointed receiver in the said proceedings and directed to collect from the United States all moneys due under the said contracts. It was further directed to hold the proceeds of such contracts for the reimbursement of The Aetna Casualty and Surety Company for expenditures made by it in the payment of furnishers of labor and material under said contracts. In the same order the action of the plaintiff was dismissed as to the defendants Henry Morgenthau, Jr., Secretary of the Treasury of the United States; William A. Julian, Treasurer of the United States; and W. E. Reynolds, Commissioner of Public Buildings. A copy of said order is attached hereto as Exhibit A.

6. Thereafter the plaintiff made demand upon the United States for the proceeds of the several contracts. Plaintiff was paid by the United States the balances due under Contract WA-2-pb-397, Whitewater, Wisconsin, in the amount of \$910, and Contract WA-2-pb-702, Skowhegan, Maine, in the amount of \$391.60. The General Accounting Office thereafter made settlements as follows: Denver, Colorado, Contract WA-2-pb-531.—The final balance payable under this contract in the amount of \$1,423.67 was applied against the indebtedness of the contractor to the United States arising out of its default under its bid for painting and repairing the St. Louis, Missouri, post office.

Tulsa, Oklahoma, Contract WA-2-pb-629.—The final balance due under this contract in the amount of \$5,116.10 was applied to the extent of \$4,353.17 to the default of the contractor under its bid for painting and repairing the St. Louis, Missouri, post office. \$762.93 of this balance was paid to and has been received by the plaintiff.

Portland, Maine, Contract WA-2-pb-609.—The final balance payable under this contract in the total sum of \$3,649 was settled in favor of the plaintiff and paid to it.

Gallup, New Mexico, Contract WA-2-pb-806.—The final balance payable under this contract in the sum of \$954.66 was applied in its entirety to the indebtedness of the contractor arising under its default in connection with its bid for painting and repairing the St. Louis, Missouri, post office.

There has accordingly been received by the plaintiff on account of all of the contracts above mentioned the total sum of \$5,713.53.

7. The plaintiff is informed and believes that The Aetna Casualty and Surety Company has an equitable lien upon the proceeds of the said several contracts to the extent of the amounts paid by it under the obligation of its bonds relating to each of said contracts, as a consequence of which the payments finally due under the several contracts were not subject to a set-off by the United

States on account of independent claims in the manner in which such set-off was made by the General Accounting Office.

8. The plaintiff and The Aetna Casualty and Surety Company protested the making of such set-offs, copies of which protests constitute Exhibits B and C hereto. The plaintiff's protests were denied by the Acting Comptroller General of the United States, a copy of which said denial forms Exhibit D, hereto attached. The receiver reported to the United States District Court the action taken upon its protest and was authorized to institute a proceeding in this Court for the recovery of such amounts. A copy of said order is attached hereto and forms Exhibit E. There is justly due and owing by the United States to the Federal Contracting Corporation the sum of at least \$3,568.23, which is impressed with an equitable lien in favor of The Aetna Casualty and Surety Company, which said lien is paramount to any right of set-off in the United States arising from sources independent of the contracts under which such sums are payable.

9. No action has been had on said claim in Congress or by any of the other departments. No person other than the plaintiff is the owner thereof or interested therein other than as set out in this petition. No assignment or transfer of this claim or any part thereof or interest therein has been made other than that made to the plaintiff by virtue of its appointment as receiver. The plaintiff is justly entitled to the amount herein claimed from the United States after allowing all just credits and offsets. The plaintiff has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to rebellion against the said Government. The plaintiff claims \$3,568.23.

HINTON & HERON,

By, ALEXANDER M. HERON,

Munsey Building, Washington 4, D. C.,

Attorneys for Plaintiff.

[Duly sworn to by C. D. Ratcliffe jurat omitted in printing.]

Exhibit A to amended petition

In the District Court of the United States for the
District of Columbia

Civil Action No. 41643

KLEIN, 875 LONGFELLOW AVENUE, NEW YORK, N. Y.

PLAINTIFF

v.

MORGENTHAU, JR., SECRETARY OF THE TREASURY OF THE UNITED
STATES, WASHINGTON, D. C., ET AL., DEFENDANTS

ORDER DISMISSING CAUSE AS TO CERTAIN DEFENDANTS AND APPOINTING
RECEIVER

Upon consideration of the motion of the Secretary of the Treasury, Treasurer of the United States and Commissioner of Public Buildings, and the consent of counsel for all parties appearing herein, it is, by the Court, this 8th day of January, 1942,

Ordered:

1. That this action be and the same hereby is dismissed as to the defendants Henry Morgenthau, Jr., Secretary of the Treasury of the United States, William A. Julian, Treasurer of the United States, and W. E. Reynolds, Commissioner of Public Buildings, with respect to all claims made herein in the complaint, answers, cross-claims and counterclaims.

2. That the Munsey Trust Company of Washington, D. C. be and it hereby is appointed Receiver in this cause to demand and receive from the United States the proceeds of all of the following contracts between the United States and the defendant Federal Contracting Corporation, a corporation:

Contract WA-2PB-531

Contract WA-2PB-629

Contract WA-2PB-597

Contract WA-2PB-600

Contract WA-2PB-702

Contract WA-2PB-806

Denver, Colorado.

Tulsa, Oklahoma.

Whitewater, Wisconsin.

Portland, Maine.

Skowhegan, Maine.

Gallup, New Mexico.

with full power and authority to give acquittance therefor to the United States, and to endorse any check or checks which may be made payable to the Federal Contracting Corporation in connection therewith and to present the same for payment by the United States, and to collect the proceeds thereof.

3. That the proceeds of all collections made by the Receiver pursuant to this order shall be held for the reimbursement of the defendant The Aetna Casualty and Surety Company for expendi-

6 UNITED STATES VS. THE MUNSEY TRUST CO., RECEIVER

tures made by it in the payment of furnishers of labor and material under the several contracts of the Federal Contracting Corporation. The Receiver shall upon making collection of funds from the United States, as herein authorized, report the same to the Court and hold the same subject to the order of this Court.

JENNINGS BAILEY,
Justice.

10 We Consent:

VERNON LOWREY,
HENRY GOODMAN,

Attorneys for Plaintiff.

EDWARD M. CURRAN,
BERNARD J. LONG,

*United States Attorney, for the Secretary
of the Treasury, Treasurer of the United States
and Commissioner of Public Buildings.*

HINTON & HERON,

By ALEXANDER M. HERON,

*Attorneys for The Aetna Casualty
and Surety Company.*

HUDSON, CREYKE & HUDSON,

By ANDREW A. LIPSCOMB,

Attorneys for Frank Wunchel.

WILLIAM T. HANNAN,

*Attorney for the Federal
Contracting Corporation.*

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Exhibit B to amended petition.

THE MUNSEY TRUST COMPANY

WASHINGTON 4, D. C., MAY 10, 1944.

To the Honorable

The Comptroller General of the United States,
Washington, D. C.

Re: Claims No. 0980866-(1), (2), (4), Certificates 0750427-429-
439-964-Klein v. Morgenthau, Civil Action No. 11643

SIR: Your office settled the above entitled contracts in favor of the Munsey Trust Company, as receiver appointed in the above entitled action. The appointment was made by order of the District Court of the United States for the District of Columbia, dated January 8, 1942, in Civil Action No. 11643 known as Klein v. Morgenthau, Jr., Secretary of the Treasury of the United States, et al., defendants. I believe you have a copy of the order of appointment; if not I will be glad to furnish same to you.

By paragraph No. 2 of the decree, the undersigned was directed to demand and receive from the United States the proceeds of these contracts made with the Federal Contracting Corporation.

By paragraph No. 3, as receiver, it was directed to hold all collections for the reimbursement of The Aetna Casualty & Surety Company for the expenditures made by it in the payment of furnishes of labor and material under the several contracts of the Federal Contracting Corporation.

The receiver is directed, upon making collection of funds from the United States as authorized, to report the same to the court and hold the same subject to the order of the court.

12 It would appear that in making settlements with the receiver with reference to these respective contracts, certain sums were withheld to be applied to the contractors' indebtedness to the United States.

According to an affidavit made on behalf of The Aetna Casualty & Surety Company transmitted herewith, that company paid certain money pursuant to the obligation of its bond to persons who furnished labor and material for use which was used in the work required under the contracts. The record in these cases will show that the surety protested, prior to the settlements, against the making of any set-offs because of charges against the contractor which arose independently of the contract. (See letter on behalf of the surety to your office dated December 17, 1942.)

Since the time of the settlements made by your office, we are advised the Court of Claims of the United States handed down its decision in the case of Maryland Casualty Co., a corporation, vs. United States, No. 45659, decided January 3, 1944. We respectfully refer you to the opinion of the court in that case. This opinion has been interpreted by us to conclude that the proceeds of a construction contract made by the United States are subject to the impression of an equitable lien in favor of a surety which pays persons who have furnished labor and material for use in the work and that this equitable lien is paramount to the right of set-off otherwise available to the United States in connection with items independent of the contract. It would accordingly follow that the proceeds of the contracts for work at Gallup, New Mexico and Tulsa, Oklahoma, are impressed by an equitable lien in favor of The Aetna Casualty and Surety Company to their full extent, since we are advised neither of them is sufficient to reimburse the surety for the payments made by it under its bond.

It follows that the application of the rule laid down in the Maryland Casualty Company case to the cases in hand have the effect of first impressing an equitable right to the contract bal-

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ances in favor of the surety to the extent necessary to reimburse it for payments made by it under its bonds. The following results:

13	Contract	Balance	Claims paid by surety	Payable to surety
	WA-2PB-597	\$910.00	\$618.00	\$618.00
	WA-2PB-702	391.60	35.00	35.00
	WA-2PB-609	3,649.00	2,528.00	2,528.00
	WA-2PB-806	954.66	7,214.83	954.66
	WA-2PB-531	1,423.67		
	WA-2PB-629	4,701.10	8,640.10	4,701.10

There has been paid to the receiver on account of all of these contracts the total sum of \$5,713.53.

From the foregoing it would appear that there is due a further payment of \$3,143.23 on account of these contracts to be paid to the receiver. Accordingly, we request that these settlements be reviewed and the additional payment forwarded to us.

Very truly yours,

(S) A. J. BYRNE,
Secretary.

Exhibit C to amended petition

HINTON & HERON

WASHINGTON, 4, D. C., March 11, 1944.

The Honorable The Comptroller General of the United States, Washington 25, D. C.

Re: Claims No. 0980866-(1)-(2)-(4)
Certificates 0750427-429-439-964

SIR: This will serve to protest the settlement made in the above-entitled matters as a result of which \$3,996.93 has been paid to the receiver appointed in the case of Klein v. Morgenthau, Jr., Civil Action No. 11643 in the District Court of the United States for the District of Columbia for the purpose of enforcing equitable rights of subrogation in favor of the contractor's surety. The Aetna Casualty and Surety Company, which was surety for the contractor on the five following contracts, paid numerous claims for labor and material furnished therefor. The amounts of the contract balances exclusive of the set-off made by your office in its recent settlement, together with the claims paid by The Aetna Casualty and Surety Company, are set out as follows:

		Contract balance	Claims paid
Whitewater	WA-2PB-597	\$910.00	\$648.00
Skowhegan	WA-2PB-702	391.60	35.00
Portland	WA-2PB-609	3,649.00	2,528.00
Gallup	WA-2PB-806	954.66	1,214.83
Denver	WA-2PB-331	1,423.67	
Tulsa	WA-2PB-629	4,701.10	8,640.10

From the foregoing it would appear to follow upon the basis of the decision of the United States Court of Claims in *Maryland Casualty Company v. The United States*, decided January 3, 1944, that the surety would be entitled to receive through the medium of the receiver a total sum of \$8,866.78. In other words, the surety would be entitled to reimbursement in full for claims paid under each contract to the extent that those contract balances were sufficient to permit such payment and the surety would be entitled to receive the payment free and clear of any independent set-offs existing in favor of the United States.

It is accordingly requested that this matter be reviewed and that a further payment of \$3,568.23 be made to the receiver on behalf of the surety.

Respectfully,

ALEXANDER M. HERON,
*Attorney for The Aetna Casualty
& Surety Company.*

AMH:LF

15

Exhibit D to Amended Petition

COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON 25, July 14, 1944.

B-17988.

THE AETNA CASUALTY AND SURETY COMPANY,
c/o Hinton & Heron, Munsey Building,
Washington 4, D. C.

GENTLEMEN: Reference is made to your letter of March 15, 1944, relative to the settlements made by this office to the Munsey Trust Company, as receiver for the Federal Contracting Corporation, covering balances due under certain contracts entered into by that corporation with the Federal Works Agency, Public Buildings Administration. You protest the application of the amount of \$6,731.50, otherwise due under said contracts, in partial liquidation of the contractor's indebtedness to the United States resulting from its default under contract No. WA 1pb 1916, dated Novem-

ber 16, 1940, alleging that since you have paid claims totaling \$13,065.23 under certain payment bonds furnished by the contractor for the protection of materialmen and laborers, you are entitled by subrogation to reimbursement in full for the claims paid under each contract to the extent that each contract balance is sufficient to permit such payment; and upon the basis that such set-off action is precluded by the decision of the Court of Claims in the case of Maryland Casualty Co. v. United States, No. 45659, decided January 3, 1944 (100 C. Cls. 513); you claim that an additional payment of \$3,568.23 is due and should be made to the receiver on your behalf.

16 At the outset, in considering the effect to be given to the holding of the Court of Claims, above referred to, it appears proper to repeat the sentiment often heretofore expressed that while the decisions of inferior courts are all given most careful study and consideration, especially where it appears that the merits of the legal principles involved have been presented to, and fully and faithfully considered by the court, nevertheless, it is the responsibility of this office, under the act of June 10, 1921, 42 Stat. 24, in the settlement and adjustment of claims, both for and against the United States, ultimately to determine the law for itself. 14 Comp. Gen. 648; 5 id. 729; 3 id. 479; id. 316.

This office does not consider the holding in the Maryland case a controlling precedent with respect to the right of subrogation of a surety to amounts otherwise due from the United States, as against the right of the Government to set off, out of such funds, moneys due from the surety's defaulting principal. The Government's right to set-off is a legal right. This is so, whether it be considered to derive from section 236, Revised Statutes, 31 U. S. C. 71 (see *Taggart v. United States*, 17 C. Cls. 322), or whether it be considered merely as a part of the general law of set-off. See *Watkins v. United States*, 9 Wall. 759, 764; *United States v. Eckford*, 6 id. 484, 488; *Pennsylvania Railroad Co. v. Miller*, 124 F. 2d 160, 162; *The Gloria*, 286 F. 188, 192; affirmed sub nom., *United States v. The Thekla*, 266 U. S. 328. When, therefore, a surety's equitable right of subrogation comes in conflict with the Government's legal right, the equitable right must yield. "Subrogation being the creature of equity * * * it will not be enforced * * * at the expense of a legal right." *German Savings and Loan Society v. Tull*, 136 F. 1, 6; *Gray v. Jacobsen*, 43 F. 2d 959; *Federal Land Bank v. Smith*, 129 Me. 233, 151, Atl. 420; *Rand v. Cutler*, 155 Mass. 451, 29 N. E. 1085.

Accordingly, and in the absence of a contrary ruling by the Supreme Court of the United States, the Maryland case may not be accepted to change or modify the long standing view of this office that the right of the United States to have its debts first satisfied from funds earned by a contractor is paramount to the right of a surety asserting a loss in making payment of the claims of materialmen and laborers, and the action heretofore taken in the matter must be, and is, affirmed.

Respectfully,

(S) FRANK L. YATES,
Acting Comptroller General
of the United States.

Exhibit E to amended petition

• Filed July 31, 1944.

In the District Court of the United States for the District of
Columbia

Civil Action No. 11643

IRVING KLEIN, 875 LONGFELLOW AVENUE, NEW YORK, NEW YORK,
PLAINTIFF

HENRY MORGENTHAU, JR., SECRETARY OF THE TREASURY OF THE
UNITED STATES, WASHINGTON, D. C., ET AL., DEFENDANTS

ORDER FOR DISTRIBUTION

Upon consideration of the report and supplemental report of the receiver herein and the consents of counsel hereto appended, it is by the Court this 31st day of July, 1944,

18 Ordered that the receiver, The Munsey Trust Company, be and it hereby is authorized to pay over to The Aetna Casualty & Surety Company \$5,213.53 from the funds in its hands and to retain the sum of \$500.00 to defray the expenses of the proceeding hereinafter authorized, and it is further

Ordered that the receiver be and it hereby is authorized and directed to institute a suit in the Court of Claims of the United States for the recovery of such other and further amounts as may be due under the contracts of the Federal Contracting Corpora-

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tion described in the complaint and answers filed in this proceeding.

DAVID A. PINE,
Justice.

Consent:

HINTON & HERON,
By (S) ALEXANDER M. HERON,
Munsey Building, Washington, D. C.
Attorneys for Defendant,
The Aetna Casualty & Surety Company.

(S) WILLIAM T. HANNAN,
Attorney for Defendant,
Federal Contracting Corporation.

(S) VERNON LOWREY,

(S) HENRY S. GOODMAN,
Attorneys for Plaintiff.

19

General traverse

Filed February 21, 1946

And now comes the Attorney General, on behalf of the United States, and answering the amended petition of the claimant herein; denies each and every allegation therein contained; and asks judgement that the amended petition be dismissed.

JOHN F. SONNETT,
Assistant Attorney General.

R. B.
EEE.

Argument and submission of case

On June 5, 1946, the case was argued and submitted on merits by Mr. Alexander M. Heron for plaintiff, and by Mr. E. E. Ellison for defendant.

21 *Special findings of fact, conclusion of law and*
-opinion of the court by Littleton, J.

Filed October 7, 1946

Mr. Alexander M. Heron for plaintiff.

Messrs. Hinton & Heron were on the brief.

Mr. E. E. Ellison, with whom was Mr. Assistant Attorney General John F. Sonnett, for the defendant.

Mr. Robert Burstein was on the brief.

The plaintiff, as receiver appointed January 8, 1942, by the U. S. District Court for the District of Columbia to collect and

distribute certain funds representing balances due under certain contracts made and performed by the Federal Contracting Corporation with the United States, sues to recover \$3,568.23 as a portion of the total of unpaid balances due under said contracts and to which The Aetna Casualty and Surety Company was entitled by reason of having paid, as a result of default in payment by the Federal Contracting Corporation, certain claims of laborers and materialmen under said contracts in the total amount of \$13,065.93.

The defendant, in September 1943, applied as an offset the amount of \$6,731.50 due it by the Federal Contracting Corporation, which was a claim not arising under any of the contracts under which plaintiff claims, against the total balances of \$12,445.03 due under certain contracts and paid the receiver the difference of \$5,713.53.

The question presented is whether the Government was entitled as against The Aetna Casualty and Surety Company to retain the total of the balances due on the contracts, to the extent of the \$3,568.23 here in controversy.

22. *Special findings of fact*

Plaintiff is a District of Columbia banking corporation with its place of business in Washington, D. C. It was appointed receiver by the District Court of the United States for the District of Columbia in an action entitled Irving Klein v. Henry Morgenthau, Jr., Secretary of the Treasury of the United States et al., being Civil Action No. 11643 in that court, and brings this suit in its capacity as receiver.

2. The Federal Contracting Corporation, a New York corporation (hereinafter sometimes referred to as the "contractor"), entered into the following contracts with the United States through the Public Buildings Administration for the painting and repair of various public buildings of the defendant:

"Post Office, Denver, Colorado, Contract WA-2-pb-531, May 10, 1940.

"Post Office and Court House, Tulsa, Oklahoma, Contract WA-2-pb-629, July 6, 1940.

"Post Office, Whitewater, Wisconsin, Contract WA-2-pb-597, July 2, 1940,

"Customs House, Portland, Maine, Contract WA-2-pb-609, July 2, 1940.

"Post Office, Skowhegan, Maine, Contract WA-2-pb-702, July 16, 1940.

"Post Office, Gallup, New Mexico, Contract WA-2-pb-806, July 26, 1940."

At the time of the execution of the above contracts, the defendant required the contractor to give two bonds with surety in connection with each of them, one bond guaranteeing the performance of the contract and the other guaranteeing payment of materialmen and laborers. The latter type of bond contained the following provision:

"Now, therefore, If the principal shall promptly make payment to all persons supplying labor and material in the prosecution of the work provided for in said contract, and any and all duly authorized modifications of said contract that may hereafter be made, notice of which modifications to the surety being hereby waived, then this obligation to be void; otherwise to remain in full force and virtue."

The Aetna Casualty and Surety Company, a Connecticut corporation, was surety on each of the bonds.

3. At the time The Aetna Casualty and Surety Company became surety on the various bonds above mentioned the Federal Contracting Corporation entered into agreements with it in connection with each of the bonds so written whereby it agreed, among other things, that it would at all times indemnify and keep indemnified The Aetna Casualty and Surety Company and save it harmless from and against all damages, loss, costs, charges, and expenses which it might at any time sustain or incur by reason of its suretyship; and further agreed that the surety should be subrogated to all its rights, privileges, and properties in the contracts, and assigned and conveyed to the surety all of the monies and properties that might be due and payable to it upon its failure to pay bills incurred on the work when they became due and payable, agreeing that the proceeds of such payments should be the sole property of the surety to be credited by it upon any damage, charge, or expense incurred by it under its bonds. Each of the agreements was identical in terms except that it related only to the specific contract and bonds in connection with which it was made.

4. At the conclusion of the work under each of the contracts referred to in finding 2 and after the allowance of credit for payments made by the United States, there remained due and owing from the United States to the contractor under each of the contracts the following amounts:

Denver, Colorado, Contract WA-2-pb-531	\$1,423.67
Tulsa, Oklahoma, Contract WA-2-pb-629	5,118.10
Whitewater, Wisconsin, Contract WA-2-pb-597	910.00
Portland, Maine, Contract WA-2-pb-600	3,649.00
Skowhegan, Maine, Contract WA-2-pb-702	391.00
Gallup, New Mexico, Contract WA-2-pb-806	954.00
Total	12,445.03

5. The contractor failed to make payment to certain persons who had furnished labor and material for use in the performance of the several contracts. The total amounts which the contractor failed to pay to such persons under each of the contracts are as follows:

Denver, Colorado, Contract WA-2-pb-531	None
Tulsa, Oklahoma, Contract WA-2-pb-629	\$8,640.10
Whitewater, Wisconsin, Contract WA-2-pb-597	618.00
Portland, Maine, Contract WA-2-pb-409	2,528.00
Skowhegan, Maine, Contract WA-2-pb-702	35.00
Gallup, New Mexico, Contract WA-2-pb-808	1,214.83
Total	13,065.93

24 The Aetna Casualty and Surety Company, pursuant to demands by the furnishers of labor and material to these jobs and in accordance with information obtained as to its liability therefor, paid to such persons the total amount of the claims set forth above and in connection therewith each of those persons assigned to The Aetna Casualty and Surety Company his rights against the contractor.

6. On October 18, 1940, the Federal Contracting Corporation (the same corporation of that name previously referred to) submitted a bid in the sum of \$20,743 for the painting of the United States Post Office at St. Louis, Missouri. The bid was accepted by the United States but the contractor failed to enter into the contract therefor in that it failed on November 16, 1940, to give the bond required in connection therewith. The United States thereupon caused the work to be performed at a cost of \$27,867 which, together with the cost of readvertising the work in the amount of \$22.50, created an indebtedness from the contractor to the United States in the amount of \$7,146.50. After the application of its bid deposit of \$415, there remained an indebtedness due from the contractor of \$6,731.50.

7. Thereafter, on June 4, 1941, one Klein, a stockholder of the contractor, instituted an action in the District Court of the United States for the District of Columbia as described in finding 1, wherein he sued the Secretary of the Treasury, the Treasurer of the United States, the Commissioner of Public Buildings, the Federal Contracting Corporation, The Aetna Casualty and Surety Company, its surety, and other persons not concerned in these proceedings. The plaintiff in that action sought the appointment of a receiver for the amounts payable by the United States under the several contracts herein mentioned and the distribution thereof to the labor and material furnishers, or in the alternative to The Aetna Casualty and Surety Company, which latter by counterclaim and crossclaim joined in the same prayers. Thereafter the plaintiff was appointed receiver in that action and

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directed by the order of its appointment to collect from the United States all monies due under those contracts and to hold the proceeds of such collection for the reimbursement of The Aetna Casualty and Surety Company, for expenditures made by it in its payment to persons furnishing labor and materials under the contracts. The same order dismissed the action as to the Secretary of the Treasury, the Treasurer of the United States, and the Commissioner of Public Buildings.

8. Pursuant to the order of its appointment, the plaintiff made demand upon the United States for the proceeds of the several contracts referred to in finding 2. The balances due from the United States on these contracts were in the total amount of \$12,445.93, as shown in finding 4, and the net indebtedness due to the United States on account of the failure of the contractor to enter into a contract for the painting of the post office at St. Louis, Missouri, was in the amount shown in finding 6, namely \$6,731.50.

The General Accounting Office made settlement of the above respective balances due from and to the United States in the following manner:

Contract	Balance due Contractor	Paid to Plaintiff	Withheld and applied to St. Louis contract indebtedness
Denver, Colorado	\$1,423.67	None	\$1,423.67
Tulsa, Oklahoma	5,116.10	\$762.93	4,353.17
Whitewater, Wisconsin	910.00	910.00	None
Portland, Maine	3,649.00	3,649.00	None
Skowhegan, Maine	391.60	391.60	None
Gallup, New Mexico	954.66	None	954.66
Total	12,445.93	5,713.53	6,731.50

9. Plaintiff and The Aetna Casualty and Surety Company each protested the above action both before and at the time such action was taken. On July 14, 1944, the Comptroller General denied the protests and affirmed the action previously taken.

Plaintiff reported these facts to the United States District Court in the action in which it was appointed and upon consideration of that report the court issued the following order:

"Upon consideration of the report and supplemental report of the receiver herein and the consents of counsel hereto appended, it is by the Court this 31st day of July, 1944,

26 "Ordered that the receiver, The Munsey Trust Company, be and it hereby is authorized to pay over to The Aetna Casualty & Surety Company \$5,213.53 from the funds in its hands and to retain the sum of \$500.00 to defray the expenses of the proceeding hereinafter authorized, and it is further

"Ordered that the receiver be and it hereby is authorized and directed to institute a suit in the Court of Claims of the United States for the recovery of such other and further amounts as may be due under the contracts of the Federal Contracting Corporation described in the complaint and answers filed in this proceeding."

10. The following tabulation shows the balances due under each of the contracts as set out in finding 4, payments by the surety to the furnishers of labor and material under each contract, as shown in finding 5, and the amount now claimed by plaintiff in this proceeding:

	Balance Due Contractor	Payments by Surety	Amount Claimed by Plaintiff
Denver, Colorado, Contract WA-2-pb-331	\$1,423.67	None	None
Tulsa, Oklahoma, Contract WA-2-pb-629	5,116.10	\$8,640.10	\$5,116.10
Whitewater, Wisconsin, Contract WA-2-pb-597	910.00	648.00	648.00
Portland, Maine, Contract WA-2-pb-609	3,649.00	2,328.00	2,328.00
Skowhegan, Maine, Contract WA-2-pb-702	391.60	35.00	35.00
Gallup, New Mexico, Contract WA-2-pb-806	931.66	1,214.33	934.66
Total	12,445.03	13,065.93	9,281.76
Less: Amounts previously paid plaintiff (see finding 8)			5,713.53
Total amount claimed by plaintiff			3,568.23

No payments have been made to the plaintiff, on account of the claims involved in this proceeding, other than herein described.

Conclusion of law

Upon the foregoing special findings of fact the court concludes as a matter of law that plaintiff is entitled to recover \$3,568.23.

It is therefore ordered and adjudged that plaintiff is entitled to recover three thousand five hundred sixty-eight dollars and twenty-three cents (\$3,568.23).

Opinion

Littleton, Judge, delivered the opinion of the court:

The question presented for determination in this case involves the legal and equitable rights of the Government and the surety on certain Government contracts who paid certain amounts for labor and material claims under its payment bonds given in connection with such contracts, in a certain portion of the total of the balances in the hands of the Government and remaining due under said contracts upon completion and acceptance of the work called for by such contracts.

In May and July, 1940, the Federal Contracting Corporation, a New York corporation, entered into six contracts with the United

States for the painting and repairing of certain Federal buildings, as set forth in finding 2. Under the terms of the bids of the Federal Contracting Corporation, the contracts, and the provisions of the act of August 24, 1935, 49 Stat. 793, payment and performance bonds were given by the contractor on each of which The Aetna Casualty and Surety Company was surety for the payment by the contractor to all persons supplying labor and material in the prosecution of the work provided for in said contracts and for the performance of work called for thereby. The contractor completed all six contracts and the work was duly accepted by defendant. The record does not show the exact dates on which these six contracts were completed, but they appear to have been completed during 1940. The Federal Contracting Corporation, however, as to five of the six contracts, defaulted under its payment bonds and under the contract in failing to make payment of \$13,065.93 to certain persons who had supplied and furnished labor and material for use in performance of the several contracts, as set forth in finding 5. Upon completion and acceptance there remained due from the Government a certain balance under each contract, which balances totaled \$12,445.03. The Government had notice of the outstanding claims for labor and material. The persons supplying labor and material to the contractor made claims upon the Aetna Company, as surety on the payment bonds given under such contracts, and the Aetna Company after having verified the correctness of such claims made payment of the several claims due under five of the contracts in the total amount of \$13,065.93 between April 7 and September 6, 1941—the last payment being in the amount of \$35.00. The

28. greater part of the total amount of all claims for labor and material was paid on May 12, 1941. By reason of these payments by the Aetna Company it became subrogated to all the rights of the Federal Contracting Corporation, the laborers and materialmen, whose claims the Aetna Company paid, and of the Government so far as its rights under the contracts were concerned, in the balances due under the contracts in connection with which the surety made such payments, to the extent of such balances, and to the extent of payments made where such payments were less than the balances due under the particular contract. *Prairie State Bank v. United States*, 164 U. S. 227; *U. S. Fidelity and Guaranty Company v. United States*, 92 C. Cl. 144. The legal and equitable rights of the surety to the balance due under said contracts were superior to those of the United States as a general creditor of the defaulting contractor on a claim arising independently of any of the contracts in connection with which the surety made such pay-

ments under its bonds. Maryland Casualty Corporation, a corporation v. United States, 100 C. Cls. 513.

The balances, totaling \$12,445.03, remaining in the hands of the Government and due under the six completed contracts were not paid, however, to the surety, as claimed by it, to the extent of \$9,281.76, finding 10, but only \$5,713.53 was paid. The difference between the total of the labor and material claims paid by the Aetna Company, and applicable to the balances remaining due under five of the contracts in the total amount of \$9,281.76, and the amount of \$5,713.53 paid to the surety by defendant, is \$3,568.23, which amount the plaintiff, on behalf of the surety, seeks to recover herein.

The refusal of the defendant to pay the Aetna Company \$9,281.76 on its claim, and to pay the plaintiff, after it was appointed receiver, the entire balances totaling \$12,445.03, was due to the fact that the Federal Contracting Corporation had become indebted to the Government for \$6,731.50 on an independent transaction not arising under any of the contracts in connection with which the surety had made payments under its payment bonds, and the claim of the Government that its right of offset was superior to any legal or equitable right which the Aetna Company, as surety, had under the contracts and the payment bonds in the balances remaining due under those contracts.

29 The offset made by the Comptroller General was the result of a settlement and adjustment made by him under authority of section 236 of the Revised Statutes, 31 U. S. Code section 71, to satisfy a debt due by the Federal Contracting Corporation to the Government which arose in the manner hereinbelow set forth.

On October 18, 1940, the Federal Contracting Corporation, pursuant to an advertisement and invitation for bids by defendant, submitted a bid in the sum of \$20,743.00 for painting the Post Office building at St. Louis, Mo. This bid was accepted by defendant, and the contractor signed the standard form of Government contract which, in its bid, it had agreed to execute. However, the contractor was unable to furnish surety bonds for performance and for payment to all persons supplying labor and material in prosecution of the work provided for in the contract. Thereupon the United States refused to award the contract to the Federal Contracting Corporation. It readvertised and relet the work to be performed to the lowest bidder at \$27,867.00, which, together with the cost of readvertising in the amount of \$22.50, created an indebtedness of \$7,146.50 from the Federal Contracting Corporation to the United States. After the application of the cash deposit of \$415.00 made by the Federal Contracting Com-

pany with its bid, there remained an indebtedness due from the contractor of \$6,731.50.

Soon after its appointment as receiver, as set forth in finding 7, plaintiff on January 10, 1942, formally notified defendant of its appointment and demanded payment to it by the United States of the balances due under the contracts hereinbefore mentioned, and requested that settlement under each of the contracts be made and that the balances due be paid over to it. Instead of doing this, the Comptroller General on September 27, 1943, made the offset of \$6,731.50, as above mentioned, and paid the balance of \$5,713.53 to plaintiff. Plaintiff protested this adjustment and settlement to the extent of \$3,568.23, and on March 15, 1944, after the decision of this court in *Maryland Casualty Company v. United States*, supra, further protested the action of the Comptroller General and requested reconsideration and payment of the additional amount of \$3,568.23 under authority of the Maryland Casualty Company decision. The Comptroller General refused to modify the settlement which he had made and advised plaintiff of his reasons therefor as follows:

"At the outset, in considering the effect to be given to the holding of the Court of Claims, above referred to, it appears proper to repeat the sentiment often heretofore expressed that while the decisions of inferior courts are all given most careful study and consideration, especially where it appears that the merits of the legal principles involved have been presented to, and fully and faithfully considered by the court, nevertheless, it is the responsibility of this office, under the act of June 10, 1921, 42 Stat. 24, in the settlement and adjustment of claims, both for and against the United States, ultimately to determine the law for itself. 14 Comp. Gen. 648, 5 id. 720; 3 id. 479; id. 316.

"This office does not consider the holding in the Maryland case a controlling precedent with respect to the right of subrogation of a surety to amounts otherwise due from the United States, as against the right of the Government to set off, out of such funds, moneys due from the surety's defaulting principal. The Government's right of set-off is a legal right. This is so whether it be considered to derive from section 236, Revised Statutes, 31 U. S. C. 71 (see *Taggart v. United States*, 17 C. Cls. 322), or whether it be considered merely as a part of the general law of set-off. See *Watkins v. United States*, 9 Wall. 759, 760; *United States v. Eckford*, 6 id. 484, 488; *Pennsylvania Railroad Co. v. Miller*, 124 F. 2d 160, 162; *The Gloria*, 285 F. 188, 192, affirmed sub nom., *United States v. The Thekla*, 266 U. S. 328. When, therefore, a surety's equitable right of subrogation comes in conflict with the Government's legal right, the equitable right must yield. Subrogation

being the creature of equity * * * it will not be enforced * * * at the expense of a legal right.' *German Savings and Loan Society v. Tull*, 136 F. 1, 6; *Gray v. Jacobsen*, 13 F. 2d. 959; *Federal Land Bank v. Smith*, 129 Me. 233, 151 Atl. 420; *Rand v. Cutler*, 155 Mass. 451, 29 N. E. 1085.

"Accordingly, and in the absence of a contrary ruling by the Supreme Court of the United States, the Maryland case may not be accepted to change or modify the long standing view of this office that the right of the United States to have its debts first satisfied from funds earned by a contractor is paramount to the
31 right of a surety asserting a loss in making payment of the claims of materialmen and laborers, and the action heretofore taken in the matter must be, and is, affirmed."

In its brief and argument in this case the defendant seeks to sustain the position taken by the Comptroller General and has reargued the question decided by this court in the Maryland Casualty Company case. We find no reason for modifying our opinion in that case.

In *Moran v. Guardian Casualty Company*, 76 Fed. (2d) 438, the Circuit Court of Appeals for the District of Columbia said:

"In *Lyttle v. National Surety Co.*, 43 App. D. C. 136, we held, in a case involving the rights of a surety who had paid the claims of laborers and materialmen under a bond similar in all respects to the one here, that the surety was entitled to be subrogated not only to the rights of the contractor, but also to the rights of the United States under the contract. The former rights are here and generally bootless, but the latter include every right which the United States were capable of asserting against contractor had the surety not satisfied the obligations of the contract. We likewise held that this equitable right or lien existed in favor of the surety from the date of the bond. We said as much again in the recent case of *Philadelphia Bank v. McKinlay, Trustee*, 63 App. D. C. 296, 72 F. (2d) 89. In these circumstances, we have no doubt that appellee, as surety, is entitled to priority, notwithstanding the subsequent assignment of the fund by contractor; and this is true even though the assignment was given for an advancement of money used in the prosecution of the work. *Prairie State Nat. Bank v. United States*, 164 U. S. 227, 17 S. Ct. 142, 41 L. Ed. 412. And see, also, *Exchange State Bank v. Fed. Surety Co. (C. C. A.)* 28 F. (2d) 485-488; where the cases are collected at great length. * * *

"In that case [of *Moran* lending money to the contractor], he is presumed to act with full knowledge of the rights of the surety, and these rights, as we have seen, include a lien in favor of the surety from the date of the execution of the bond, for the surety

by the terms of the bond is bound to the payment of all claims growing out of the performance of the contract. And this, of itself, creates the equitable right of subrogation. The subsequent assignment, therefore, was wholly insufficient to create a superior lien to the then existing lien of the surety (appellee). These principles are so elementary that further discussion would obviously be out of order."

In *Farmers' Bank v. Hayes, et al.*, 58 Fed. (2d) 34, 37, the court said:

"This is on the principle that a surety who gives bond to the owner to insure performance of a building contract by the contractor is subrogated to the rights of the owner in the percentage which the owner retains as security for the performance of the contract, when upon default by the contractor the surety performs, as in *Prairie State National Bank case*, or on the principle that when the contractor performs his obligation to the owner, but fails to pay labor and materialmen, and the surety is obliged to do so under his bond, the surety is subrogated to liens of laborers and materialmen upon the fund reserved by the owner, as in the *Hemmingsen case*. The distinction between the *Prairie Bank* and the *Hemmingsen cases* is pointed out by this Court in *Belknap Hardware & Manufacturing Company v. Ohio River Contract Company*, 271 Fed. 144. But, whether in the instant case the surety's rights arise out of subrogation to the rights of the Board of Trust or of the equitable liens of the laborers and materialmen, the result is the same. In either case the equitable rights of the surety become fixed as of the date of the bond, and are superior to those of any holder of an after acquired lien. Whether the lien of the surety extends only to the reserved percentage under the contract, or also to sums earned under the contract, and retained by the owner, is a question which has frequently been raised. We think it is now settled that it extends to both. * * *

In *United States Fidelity and Guaranty Company v. Sweeney*, 80 Fed. (2d) 235, the court said:

"* * * Laborers and materialmen, however, have an equitable right to payment from funds due a contractor on a public improvement in preference to general creditors. *Belknap Hardware & Manufacturing Co. v. Ohio River Contract Co.* (C. C. A. 6), 271 Fed. 144. The statutory requirement of a bond to protect them is not inconsistent with such equitable rights. *American Surety Co. v. Westinghouse Elec. Mfg. Co.* (C. C. A. 5), 75 Fed. (2d) 377. There is a recognized equitable right of unpaid furnishers of labor or materials to such part of the contract price as may remain in the possession of the Government after the completion of the work by the contractor. *Riverview State Bank v. Wentz* (C. C. A. 8), 34 Fed. (2d) 419; *Hen-*

ningsen v. United States Fidelity and Guaranty Co., 208 U. S. 404, 28 S. Ct. 389, 52 L. Ed. 547; Farmers' Bank v. Hayes (C. C. A. 6); 58 Fed. (2d) 34; American Surety Co. v. Westinghouse Elec. Mfg. Co. (C. C. A. 5), 75 Fed. (2d) 377.

"Appellant was bound by contract to pay the claims for labor and material, and upon paying these claims it was entitled to be subrogated to the superior equities of the laborers and materialmen, and when payment was made its rights related back to the time of making the contracts. *Prairie State Bank v. United States*, 164 U. S. 227, 17 S. Ct. 142, 145, 41 L. Ed. 412; *Henningsen v. United States Fidelity and Guaranty Co.*, 208 U. S. 404, 28 S. Ct. 389, 52 L. Ed. 547; *London and Lancashire Indemnity Co. v. Endres* (C. C. A. 8), 290 Fed. 98; in re: *Scotfield Co.* (C. C. A. 2), 215 Fed. 45; *Farmers' Bank v. Hayes* (C. C. A. 6), 58 Fed. (2d) 34."

In *Morgenthau, et al. v. Fidelity & Deposit Company of Maryland*, 94 Fed. (2d) 632, the court said:

"The surety claims an equitable lien on the fund grounded upon the assignment made by the contractor as consideration for the execution of the bond. It likewise claims the fund by subrogation on account of the money paid out by it to complete the contract and discharge the claim."

We are of opinion that the surety's position in this latter respect is sustained by reason and authority. Its bond was that the contractor would complete the contract and pay promptly all persons furnishing labor and materials in connection therewith. The contractor failed to carry out his contract, and the surety advanced the money, and in addition paid all the labor and material bills still unpaid. It did this, not as a volunteer, but by reason of its contract entered into before the commencement of the work. Its advance to the contractor and its payment to the laborers and materialmen released the contractor from his obligations under the contract and, as the Supreme Court said in *Henningsen v. U. S. F. and G. Company*, 208 U. S. 404, * * * likewise released the Government from all equitable obligations to see that the laborers and supplymen were paid. It thereby became subrogated to the equity of the United States. Its action created in itself an equitable right which entitled it to demand and receive the balance due from the United States, and this equitable right, as the Supreme Court said in *Prairie State Bank v. U. S.*, 164 U. S. 227, * * * arose from and related back to the date of the original contract of suretyship. * * *

Aside from the question of whether persons who supply labor and material for use on work under a public contract, or the surety who pays their claims, acquires an equitable lien on the balance

due under the contract upon completion thereof, including the retained percentage, we are of opinion under the long line of decisions involving the rights of laborers and materialmen, and sureties, that the equities of such laborers and materialmen, and of the surety who pays their claim, in any balance remaining due under the contract on which the contractor defaulted in payment, are clearly superior to the rights of general creditors, including the Government. When the surety pays labor and material claims upon which the contractor defaulted, the surety's rights relate back to the date of the bond, which, in this case, was prior to the date on which the Federal Contracting Corporation became indebted to the United States on November 16, 1940, when it failed to furnish a bond under a contract with the defendant pursuant to its bid. The reason for the rule that such claims are superior to those of general creditors is that the persons who supply labor and material, although having no legal cause of action against the United States, because not in contractual relation with the United States, in effect furnished the Government with a part of what its contract called for and, having received the benefit of such labor and material, the Government is not entitled, as a general creditor, to retain the balance due under the contract and apply it in satisfaction of an independent claim against the defaulting contractor.

In *Maryland Casualty Co. v. United States*, supra, we held that the contract, the bond, and the transaction as a whole should be construed "as implying a promise on the part of the Government to the surety that it will not so settle the account of the contractor as to leave the surety in the position of paying the contractor's taxes."

We think it is immaterial that the laborers and materialmen, not being in contractual relation with the United States, and, by reason of the provision in the contract that all material and work covered by partial payments made should thereupon become the sole property of the Government prevented them from having a lien upon the structure, had no legally enforceable claim against the United States for the balance due under the contract. The equitable interests of laborers and materialmen and the surety on the payment bond given under the contract and the requirements of the act of Congress (40 U. S. C. 270 (a), (b), (c), and the earlier acts of August 13, 1894, 28 Stat. 278, and February 24, 1905, 33 Stat. 811) have been firmly established without exception by a long line of decisions. These decisions hold, first, that the priority or preference of the United States in payment of its debts in the case of insolvency, of its debtor is inferior to an existing equitable lien; second, that sup-

pliers of labor and material, as well as a surety who has paid their claims, have a lien upon a public structure where the contract did not vest in the United States title to the work and the material as the work progressed and progress payments were made (*United States v. Ansonia Brass & Copper Company*, 218 U. S. 453); third, that the equities of laborers and materialmen, and sureties upon the bond, in any balance remaining due under the contract, including retained percentages, are superior to the rights and claims of general creditors and assignees of the defaulting contractor.

With respect to the superior equities of the laborers and materialmen and the surety upon a payment bond, the court, in *Henningsen v. United States Fidelity and Guaranty Company of Baltimore, Maryland*, supra, said:

"The Guaranty Company was surety on that contract [for the construction of the public work]. Its stipulation was not merely that the contractor should construct the buildings, but that he should pay promptly and in full all persons supplying labor and material in the prosecution of the work contracted for. He did not make this payment, and the Guaranty Company, as surety, was compelled to and did make the payment. Is its equity superior to that of one who simply loaned money to the contractor to be by him used as he saw fit, either in the performance of his building contract or in any other way? We think it is. It paid the laborers and materialmen, and thus released the contractor from his obligations to them; and to the same extent released the Government from all equitable obligations to see that the laborers and supply men were paid. It did this not as a volunteer but by reason of contract obligations entered into before the commencement of the work [citing cases]."

With respect to any balance, including reserved percentage under a contract where the contractor has defaulted upon the payment bond, the effect of the statute requiring such bond, the contract and the bond itself, when read together, is to make the equity of laborers and materialmen and the surety superior to the claims of general creditors and subsequent assignees of the defaulting contractor, and out of this equity there grows a right or interest of the laborers and materialmen and the surety in the retained percentage which, even if not a lien in the strict and proper sense, brings kindred consequences along with it, and a court applying equitable principles in such case will come to the aid of one whose equity is superior. In the case at bar the United States was, upon completion of the contracts by the Federal Contracting Corporation, a stakeholder of the balance due thereunder in the total amount of \$12,445.03 for payment or distribution thereof to the persons entitled thereto. Although the Government was not legally

liable to the suppliers for labor and material to the defaulting contractor, because they were not in contract relation with it and had no established lien upon the structure, or upon the balances due under the contracts, nevertheless as held in *Henningsen v. U. S. Fidelity & Guaranty Co.*, supra, certain equitable obligations rested upon the Government to see that the laborers and supply men were paid to the extent of any amount, or balance, remaining due under the contracts. The surety on the defaulting contractor's payment bond was in contractual relation with the United States, and when it paid the claims of the laborers and supply men against the Federal Contracting Corporation it was subrogated to all the equity in favor of laborers and supply men. The right of the surety to make demand and to receive any balances due under the contracts, to the extent of such balances or to the extent of the payments so made, as against all general creditors of the defaulting contractor related back to the date of the payment bond which, in this case, was July 1940.

37 In addition to being a stakeholder of the balances due under the contracts involved in this case, the United States in November 1940 became a general creditor of the Federal Contracting Corporation by reason of the failure of that corporation to enter into another contract with the Government pursuant to its accepted bid. It was therefore a general creditor of the defaulting contractor on a claim not arising under the contracts in respect of which it held certain unpaid balances. In these circumstances the claim of The Agna Casualty and Surety Company and of the plaintiff, as receiver for the balances due under the completed contracts with the Federal Contracting Company to the extent of \$9,281.76 (finding 10), was and is superior to the claim of the United States, as a general creditor on an independent claim.

The defendant argues, however, that the legal right of the Government to satisfy its independent claim against the defaulting contractor by the offset made September 27, 1943, was superior to and superseded any legal or equitable claim which laborers and materialmen, or the surety, had with respect to the contract balances in its hands, since the Government had no obligation to pay debts of the defaulting contractor to laborers and materialmen, and since the amount due from the Government under the completed contracts was not a trust fund for the satisfaction of such claims. This argument as to the superior right of the Government in the contract balances is based upon the general right of the Government, which is the common right of any creditor, to apply the unappropriated monies of its debtor in its hands to the extinguishment of the debt due the Government and, also upon

the provisions of section 236 R. S., as amended (34 U. S. C., sec. 71).³

Neither the general right of the Government to make offsets nor the provisions of sec. 236 R. S. give to the claim of the Government any greater equitable force and effect than would attach to the claim of any general creditor to the contract balances in the Government's hands. The provision for administrative settlement and adjustment of claims and demands by the Government, or against it, and all accounts with which the Government is concerned, either as debtor or creditor amounted to no more than the statutory declaration of a right which the Government would otherwise have, and the term "settled and adjusted" was used to describe administrative determination of the amount due, either by or to the Government. The statutory provision for administrative settlement and adjustment of accounts has been in effect in substance since the enactment of section 3 of the act of September 2, 1789, 1 Stat. 65, establishing the Treasury Department. This statutory provision as to administrative settlement and adjustment of claims and accounts, with which the Government is concerned, has never been held by the courts to create a preference or priority in favor of the United States in respect of any debt that might be due it. This matter is taken care of by other statutory provisions, such as R. S. 3466 and the bankruptcy statutes. The statutory provision for administrative settlement and adjustment of claims and accounts is directory and was enacted for the purpose of designating the official who should be charged with that administrative duty and responsibility. "Whether the amount so fixed is due, in law and fact, undoubtedly remains a question to be adjudicated, if properly raised in judicial proceedings. * * * Illinois Surety Company in v. United States to the Use of Peeler et al., 240 U. S. 214, 221.

This court has jurisdiction and authority under section 145 of the Judicial Code, 28 U. S. Code 250 (1), to apply equitable principles where applicable in suits against the United States for a money judgment. This is such a case, since the claim here made by plaintiff, as receiver, arose under contracts with the United States, and the statute expressly provides that this court shall have jurisdiction to hear and determine all such claims "in respect of which claims the party would be entitled to redress against the United States, either in a court of law, equity, or admiralty, if the

³ All claims and demands whatever by the Government of the United States or against it, and all accounts whatever with which the Government of the United States is concerned, either as debtor or as creditor, shall be settled and adjusted in the General Accounting Office.

United States were suable." Cf. *Seminole Nation v. United States*, 316 U. S. 286, 294-300.

For the reason stated and in view of the authorities cited, we hold that the right of surety and of plaintiff, as receiver, which is in the nature of an equitable lien, to have the contract balances in the Government's hands applied in satisfaction of payments made by the surety to laborers and materialmen cannot be displaced by the Government's general right of offset.

Plaintiff is entitled to recover \$3,568.23 and judgment will be accordingly entered in its favor for that amount. It is so ordered. Jones, Judge; Whitaker, Judge; and Whaley, Chief Justice, concur.

Madden, Judge, took no part in the decision of this case.

41

Judgment of the court

Oct. 7, 1946

Upon the special findings of fact, which are made a part of the judgment herein, the court decides as a conclusion of law, that the plaintiff is entitled to recover \$3,568.23.

It is therefore ordered and adjudged that the plaintiff recover of and from the United States the sum of three thousand five hundred sixty-eight dollars and twenty-three (\$3,568.23).

43. [Duly sworn to by jurat omitted in printing.]

Supreme Court of the United States

No. 847, October Term, 1946 ..

Order allowing certiorari

Filed March 3, 1947

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.